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The Revenue Reconciliation Act of 1993

Tax Provisions of Significance to Farmers and Rural America

Michael Compson and Ron Durst

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Abstract

The Revenue Reconciliation Act of 1993 (RRA 1993) contains numerous tax provisions that will affect farmers and rural Americans. With the exception of the transportation fuels tax, the tax increases are aimed at higher-income taxpayers and corporations. As such, most farmers and rural Americans will not be directly affected by most of the tax increases. In addition, onfarm use of transportation fuels is exempt from the Federal excise tax, further limiting the effect of tax increases on farmers. RRA 1993 also contains several provisions that should help small businesses and low-income working Americans. Specifically, RRA 1993 extends and expands the self-employment health insurance deduction, simplifies and expands the earned income tax credit for low-income workers, and provides incentives for empowerment zones and enterprise communities. On balance, the positive impact of the tax incentives should offset the tax increases for most farmers and for rural communities.

Keywords: marginal income tax rates, self-employment health insurance deduction, earned income tax credit, capital expensing, empowerment zones, and enterprise communities.

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Introduction

The Omnibus Budget Reconciliation Act of 1993 was signed into law by President Clinton on August 10, 1993. The Act is expected to reduce the Federal budget deficit by nearly $500 billion from 1994 to 1998 through a combination of tax increases and reductions in the growth of Federal expenditures. Although the Act's tax and expenditure provisions will affect all Americans, this analysis focuses on the tax provisions of significance to farmers and rural communities.[1]

The relevant changes contained in the Revenue Reconciliation Act of 1993 (RRA 1993) are grouped into three categories; changes affecting individuals, changes affecting businesses, and changes affecting rural areas.[2] The prior law status of each evaluated provision is highlighted to place the change in historical context. This is followed by a description of how the Act changes prior law and an analysis of the implications of the change. Specific estimates of the potential effect of the various changes in the Federal tax code contained in RRA 1993 are provided. These estimates are generated using the 1990 Internal Revenue Service (IRS) Individual Public Use Tax File. The IRS data is a sample of actual tax returns with weights to represent the tax-filing population of the United States. Unfortunately, the tax data do not allow researchers to distinguish between rural and urban taxpayers. As a result, the point estimates are limited to farm sole proprietors and farm landlords.

Tax Changes Affecting Individuals

Increasing Marginal Income Tax Rates For High-Income Taxpayers

Under prior law, there were three statutory marginal income tax rates, 15, 28, and 31 percent. The three-bracket tax regime was a result of the Tax Reform Act of 1986 (TRA) and the Revenue Reconciliation Act of 1990 (RRA 1990). TRA significantly reduced both the number of tax brackets and the marginal income tax rates. After a 4-year phase-in period, the number of statutory brackets was reduced from 13 to 2 and the top rate was reduced from 50 to 28 percent.

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[1] All tax provisions are contained in the '93 Revenue Reconciliation Act, Chapter 1 of Title XIII of the Omnibus Budget Reconciliation Act of '93.

[2] Several provisions affect more than one category. Provisions were placed in categories on the basis of primary impact and ease of exposition.

Some high-income returns had a 5 percent differential between the statutory tax rates and the effective marginal tax rates as a result of the so-called "bubble." For these high-income returns the benefits of the 15-percent tax bracket and the personal exemptions were phased out, creating an effective marginal tax rate of 33 percent.

A large part of the deficit reduction contained in RRA 1990 was achieved by increasing the top marginal income tax rate from 28 to 31 percent, creating three tax brackets of 15, 28, and 31 percent. In addition, the "bubble" was repealed and replaced by provisions reducing the deduction for personal exemptions and limiting itemized deductions for certain high-income returns. As a result of these two provisions, the effective tax rate for some high-income returns exceeded the statutory 31 percent. Both of these provisions were scheduled to expire after 1995.

The new law makes several changes that continue the increase in marginal income tax rates for high-income individuals begun in 1990. First, the top marginal income tax rate increases from 31 to 36 percent for single individuals with taxable income over $115,000 and for joint returns with taxable income above $140,000. Second, the law imposes a surtax of 10 percent on taxable income over $250,000 for both joint and single returns, creating a fourth tax bracket at 39.6 percent. The surtax does not apply to net capital income, thereby maintaining the current maximum tax on capital income at 28 percent. In addition, the new law makes permanent the limitations on itemized deductions and the phase-out of the personal exemption for high-income taxpayers that were scheduled to expire after 1995.

The increase in marginal income tax rates will only affect about 2 to 3 percent of farm sole proprietors (table 1). The surtax will affect less than 1 percent of farm sole proprietors.[3] Although the number of farm sole proprietors affected by the increase in marginal income taxes is very small, these farmers could see a significant increase in their tax liabilities. The combination of increasing the top marginal income tax rates to 36 and 39.6 percent and maintaining the top rate on capital income at 28 percent provides an incentive for individuals to reduce their tax burden by investing in farmland and other assets eligible for capital gains treatment.

The Federal tax code contains an alternative minimum tax (AMT) to ensure that individuals who would otherwise be able to substantially reduce or even eliminate their tax liabilities through the use of tax preferences pay at least some Federal income tax. The AMT is paid in addition to the individual's regular Federal income tax and equals the excess of the taxpayer's tentative minimum tax over his/her regular Federal income tax. The tentative minimum tax is determined by subtracting the exemption amount from the taxpayer's alternative minimum taxable income (AMTI) and multiplying that amount by the 24-percent applicable tax rate. AMTI equals regular taxable income plus specific tax benefits or preferences. For individual farmers, the most important additions to taxable income include accelerated depreciation, tax-exempt interest, passive farm losses, and certain itemized deductions and personal exemptions. The exemption is $40,000 for married couples filing a joint return and $30,000 for single returns.

The new law replaces the current 24-percent alternative minimum tax rate with a two-tier graduated rate schedule. A 26-percent rate applies to the first $175,000 of AMTI above the exemption amount, and a 28-percent rate applies to any AMTI above that amount. The exemption amount increases from $40,000 to $45,000 for joint returns and from $30,000 to $33,750 for single returns. Very few farm sole proprietors have been subject to the alternative

[3] The distribution of farm sole proprietors based on taxable income minus net capital income was very similar to the distribution by taxable income shown in table 1.

Table 1--Impact of increasing marginal income tax rates on farm sole proprietors

Taxable income: Over	Taxable income: But not over	Current law marginal tax rate	New law marginal tax rate	Number of returns	Percent of farm sole proprietors
		---Percent---		Number	Percent
Single returns:					
Less than	$22,100	15	15	295,643	12.70
$22,100	$53,500	28	28	66,741	2.80
$53,500	$115,000	31	31	6,585	0.20
$115,000	$250,000	31	36	4,354	0.18
$250,000	Above	31	39.6	1,807	0.07
Total				375,133	15.95
Joint returns:					
Less than	$36,900	15	15	1,481,968	63.7
$36,900	$89,150	28	28	311,835	13.40
$89,150	$140,000	31	31	42,425	0.18
$140,000	$250,000	31	36	22,531	0.96
$250,000	Above	31	39.6	20,402	0.87
Total				1,879,163	80.8

Source: 1990 IRS Individual Public Use Tax File.
Notes: The percentages of farm sole proprietors filing single or joint returns do not sum to 100 percent because the table does not include head of household, widow (er) with dependent child, and married but filing separate returns.

minimum tax (table 2). As a result, the effect of the changes in the alternative minimum tax on farm sole proprietors is likely to be minimal.

The increases in marginal income tax rates and the AMT are retroactive to January 1, 1993. Since the increased tax liabilities were not accounted for by Federal income tax withholding, the Act contains a provision that allows individuals affected by the higher rates the option of paying the additional taxes in three equal installments over 3 years without interest.

Transportation Fuels Tax

Under prior law, the Federal excise tax on gasoline and diesel fuel was 14.1 and 20.1 cents per gallon, respectively. The excise tax collected from those purchasing motor fuels is designed to maintain the highway system in the United States. As a result, all onfarm uses of gasoline and diesel fuel are exempt from the tax. Farmers currently must claim a credit for the gasoline and special fuels excise taxes paid and may claim either a credit or refund for excise taxes paid for diesel fuel used on the farm. Farmers also have the option of obtaining a waiver to permit them

Table 2--Alternative minimum tax payments (AMT) made by farm sole proprietors

Item	1987	1988	1989	1990
Number of returns paying AMT	13,290	10,986	7,547	8,041
Percentage of all farm tax returns	0.5	0.4	0.3	0.3
Total AMT paid	$166,407,000	$104,507,000	$85,686,000	$89,487,000
Average AMT paid	$12,521	$9,512	$11,353	$11,128

Source: IRS Individual Public Use Tax Files, 1987-1990.

to purchase diesel fuel for onfarm use free of the excise tax. The last increase in the Federal excise tax was part of RRA 1990, which raised the excise tax by 5 cents per gallon effective December 1, 1990.

The 1993 Act contains a transportation fuels tax that increases the Federal excise tax on gasoline, diesel fuel, compressed natural gas, and noncommercial aviation fuel (commercial aviation fuel is exempt for 2 years) by 4.3 cents per gallon effective October 1, 1993. Since gasoline and diesel fuel used on the farm is exempt from the Federal excise tax, this increase will have a limited effect on farmers. Like other sectors of the economy, farmers will face slightly higher costs in transporting their product to market. In addition, farmers and other rural residents may face disproportionately higher nonbusiness transportation costs than their urban counterparts since they tend to drive more. However, given the size of the increase in the Federal excise tax, it should not represent a significant burden for most farmers and rural residents.

Increasing the Percentage of Social Security Benefits Subject to Taxation

The Social Security Amendments of 1983 (SSA 1983) required high-income beneficiaries to include a portion of their Social Security benefits in adjusted gross income (AGI) for tax purposes. The tax status of benefits is determined by the level of modified adjusted gross income (MAGI) and by filing status. In general, MAGI equals the sum of AGI, nontaxable interest income, and one-half of Social Security benefits. The thresholds for taxing benefits were $25,000 for single individuals and married taxpayers who file separately and do not live together during the year, $32,000 for joint returns, and zero for married taxpayers filing separately who lived together at any time during the year. For returns with MAGI just above the threshold, the lesser of one-half of their benefits or one-half of the amount by which MAGI exceeds the threshold is included in AGI.[4]

The new law increases from 50 to 85 percent the amount of Social Security benefits that certain high-income returns are required to include in AGI for tax purposes. In effect, the law creates a

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[4] Under SSA 1983, the Treasury is required to estimate the tax liability attributable to Social Security benefits and to transfer that revenue to the respective trust funds. As a result of this transfer, the inclusion of benefits in AGI is viewed as a reduction in Social Security benefits as opposed to an increase in taxes.

Table 3--Impact of taxing Social Security benefits under previous law

Item	Unit	Farm sole proprietors[1]	Farm landlords[1]
All returns	Number	2,323,304	575,105
Percentage of returns reporting gross benefits	Percent	14.6	44.5
Returns reporting benefits in AGI	Percent	6.7	22.0
Returns reporting benefits in AGI as a percentage of returns reporting gross benefits	Percent	46.0	49.5
Total benefits in AGI	Mil. dol.	649	539
Total benefits in AGI as a percentage of total gross benefits reported	Percent	20.0	22.6
Average benefits in AGI	Dollars	4,120	4,247
Total tax liability attributable to benefits	Mil. dol.	156	132
Average tax liability attributable to benefits	Dollars	992	1,041

[1] To avoid double-counting, individuals who reported both farm income (loss) and farm rental income were considered to be farm sole proprietors. Individuals who reported only farm rental income and no farm income (loss) were considered farm landlords.
Source: 1990 IRS Individual Public Use Tax File.

two-tier system for taxing benefits, those required to include 50 percent of their benefits in AGI and those required to include 85 percent. While the previous definition for MAGI remains intact, the thresholds for including 85 percent of benefits in AGI are $34,000 for single returns and $44,000 for joint returns. Individuals with MAGI greater than $25,000 but less than $34,000 ($32,000 to $44,000 for joint returns) are still required to include 50 percent of their benefits in AGI. Unlike the revenue generated from including 50 percent of benefits in AGI, the revenue generated by including the additional 35 percent of benefits in AGI will be transferred to the Medicare Hospital Insurance (HI) Trust Fund.

According to 1990 IRS estimates, nearly 15 percent of all farm sole proprietors and 45 percent of all farm landlords reported gross Social Security benefits (table 3).[5] Under previous law, nearly 7 percent of farm sole proprietors and 22 percent of farm landlords were required to include a portion of their Social Security benefits in AGI for tax purposes. Farm sole proprietors were required to include $650 million dollars, nearly 20 percent of their gross benefits in AGI. The average amount of benefits was $4,120. Farm landlords included $539 million, nearly 23 percent

[5] To avoid double-counting, individuals who reported farm income (loss) and farm rental income were considered to be farm sole proprietors. Only individuals who reported farm rental income without farm income (loss) were considered farm landlords.

of their gross benefits in AGI. On average, farm landlords included $4,247 of their benefits in AGI.

The new law will affect nearly two-thirds of the farm sole proprietors and farm landlords currently required to include a portion of their benefits in AGI. The farm sole proprietors affected by the new law will see the total amount of benefits they must include in AGI increase by about $350 million. Their total Federal income tax liability attributable to benefits will increase by about $100 million, with the average liability increasing by nearly $1,000. Farm landlords affected by the new law will see the total amount of benefits they include in AGI increase by approximately $300 million. The total tax liability attributable to benefits for these landlords will increase by $84 million, with their average tax liability increasing by $1,100. As a result of the new law, the average tax liability attributable to benefits for affected farm sole proprietors and farm landlords will be about $2,300 and $2,500, respectively.

Repealing the Medicare Hospital Insurance Tax Wage Cap

Under prior law, the medicare hospital insurance (HI) portion of the Federal Insurance Contribution Act (FICA) was 2.9 percent (1.45 percent for both the employer and the employee) of wage and self-employment income up to $135,000. Prior to RRA 1990, the cap on the HI portion of FICA was set the same as the old-age, survivor disability insurance (OASDI). RRA 1990 increased the cap on wage and self-employment income subject to the HI tax from $53,400 to $125,000. The cap was indexed for subsequent years.

The new law removes the cap and subjects all wage and self-employment income to the HI tax effective January 1, 1994. Based on 1990 IRS data, fewer than 1 percent of all farm sole proprietors had income above the current dollar limit. These individuals will be required to pay an additional 2.9 percent on all self-employment (1.45 percent on wage) income above $135,000.

Increasing the Federal Estate and Gift Tax Rates

In 1992, the top Federal estate and gift tax rate was 55 percent for taxable estates in excess of $3 million. Beginning in 1993, the top rate was reduced to 50 percent applicable to estates over $2.5 million. The Act restores the 55 percent rate for estates over $3 million and applies a 53 percent rate for estates between $2.5 and $3 million. Based on IRS statistics, only about 200 farm estates per year would be of sufficient size to be affected by these increased rates (table 4).

Simplifying and Expanding the Earned Income Tax Credit

The earned income tax credit (EITC) is designed to assist low-income working families. The prior EITC was a three-part credit that included a basic credit, a young child credit, and a health insurance credit. The basic EITC rate was 18.5 percent of the first $7,750 for a worker with one child (a maximum credit of $1,434) and 19.5 percent for a worker with two or more children (a maximum credit of $1,511). The young child credit and health insurance credit increased the basic EITC rate by 5 and 6 percentage points, respectively (thereby increasing the maximum credit amount by $338 and $465, respectively). The credits were phased out starting with incomes over $12,000 and were not available for taxpayers with incomes above $23,050

Under the Act, by 1995, the basic EITC rate for families with one child increases to 34 percent applicable to the first $6,000 of earned income (plus an inflation adjustment). In 1995, the maximum credit for a family with one child is projected to be $2,100. The credit is phased out for families with income of between $11,000 and $23,760. Families with two or more qualifying children will receive a credit in 1996 of 40 percent of the first $8,425 of earned income (plus an

Table 4--Estate tax returns with farm property

Size of gross estate	1989		1990	
	Number	Estate amount ($000's)	Number	Estate amount ($000's)
All returns	2,911	307,601	3,754	238,630
$600,000 - $1,000,000	1,588	109,481	2,151	88,836
$1,000,000 - $2,500,000	987	64,481	1,212	88,330
$2,500,000 - $5,000,000	207	16,210	239	20,867
$5,000,000 - $10,00,000	80	22,126	91	22,298
$10,000,000 - $20,000,000	28	16,160	38	6,154
$20,000,000 or more	22	76,975	24	12,145
Taxable returns	1,148	140,296	1,480	72,965
$600,000 - $1,000,000	452	13,587	634	15,126
$1,000,000 - $2,500,000	520	21,822	601	25,546
$2,500,000 - $5,000,000	85	3,333	144	12,460
$5,000,000 - $10,00,000	55	16,849	59	10,476
$10,000,000 - $20,000,000	19	10,850	27	3,688
$20,000,000 or more	17	73,857	15	5,669

Source: IRS Statistics of Income Bulletin, Winter 1991-1992, Washington, DC, 1992, p. 65 and 68.

inflation adjustment) for a projected maximum credit of $3,370. The credit is phased out for those families with income between $11,000 and $27,000. The young child and health insurance credits available under prior law are repealed.

For the first time, the earned income credit is extended to qualified low-income workers without children. Qualifying individuals must be over 25 and less than 65 years of age and cannot be claimed as a dependent on another taxpayer's return. In 1994, their EITC is 7.65 percent of the first $4,000 of earned income (for a maximum credit of $306). The credit is phased out for taxpayers with income between $5,000 and $9,000.

The revised EITC will substantially increase both the amount of the credit and the number of farm sole proprietors eligible to claim the credit.[6] The increase in the phase-out range from $23,050 to $27,000 for multichild families could increase the number eligible by approximately 40,000 farm sole proprietors. The extension of the earned income credit to low-income workers without children will benefit approximately 250,000 farm sole proprietors. The proposed increase in the earned income tax credit should provide farm sole proprietors with an additional $200 million by 1995, about 85 percent more than the estimated amount of the credit received by farm sole proprietors in 1993. The majority of the increase will accrue to households with two or more

[6] The estimates of the impact of the revised EITC on farm sole proprietors were generated using a two-step procedure. The first step imposed the 1993 EITC parameters on the 1990 IRS data to determine eligibility and the amount of EITC that individuals could claim. The next step imposed the parameters of the new law on the 1990 data set and generating estimates for eligibility and the amounts that could be claimed. The differences between the estimates is the impact of the new law.

children. Extending the credit to low-income workers with no children accounts for only about 20 percent of the increase.

Extending and Expanding the Self-Employment Health Insurance Deduction

As a result of TRA, self-employed individuals could deduct 25 percent of the cost of their health insurance premiums from taxable income. This provision was extended each year from 1987 to 1991, before it was allowed to expire on June 30, 1992. The deduction partially addresses the disparity in the Federal tax treatment of self-employed individuals and wage earners in the area of health insurance. Current Federal tax law exempts the entire amount of an employer's contribution toward an employee's health insurance from the employee's Federal, State, and local income and Federal payroll taxes. Companies offering their employees health insurance can fully deduct the cost of providing such coverage as a business expense. As such, the Federal tax code provides more favorable treatment for companies providing health insurance and their employees relative to self-employed individuals.

The prior deduction was limited to individuals without access to employer-provided health insurance at any time during the year and could not exceed self-employment income. The 25-percent deduction lowered the after-tax cost of health insurance for farm sole proprietors, partners in farm partnerships, and certain shareholders in Subchapter S corporations and their families. However, many self-employed individuals were still at a disadvantage relative to those covered under an employer-sponsored health insurance plan.

The new law extends the deduction through December 31, 1993, retroactive to June 30, 1992, and expands eligibility for the deduction by determining eligibility on a monthly rather than a yearly basis. For example, a family that is eligible for coverage under an employer-sponsored health plan for 6 months out of the year will be able to deduct 25 percent of the health insurance premiums for the 6 months they had to purchase their own insurance. Under prior law, families eligible for employer-sponsored coverage at any time during the year were not eligible for the deduction.

Table 5--Self-employment health insurance deductions claimed by farm sole proprietors

Item	Unit	1988	1989	1990
Number of farm returns claiming deduction	Number	329,652	391,466	428,959
Percentage of farm returns claiming deduction	Percent	13.9	16.5	18.4
Total amount deducted by farm returns	Dollars	155,882,000	215,591,000	265,075,000
Average amount deducted by farm returns	Dollars	473	551	618

Source: IRS Individual Public Use Tax Files, 1988-1990.

The number of farm sole proprietors claiming the self-employment health insurance deduction increased by nearly 100,000 returns from 1988 to 1990 (table 5), from nearly 14 percent to 18.4 percent. The total amount claimed increased by 70 percent in nominal terms while the average amount claimed increased by approximately $145. Expanding eligibility for the deduction will likely increase the number of farm sole proprietors claiming the deduction. Extending the deduction will affect a relatively large percentage of farm sole proprietors and will partially match the tax benefits available to many salaried employees.[7]

Tax Changes Affecting Businesses

Increased Corporate Tax Rates and Limits on Business Deductions

The new law contains a number of tax increase provisions aimed at corporations and business expenses. Under prior law, the top corporate tax rate was 34 percent applicable to taxable income over $75,000. The Act increases the top corporate tax rate from 34 to 35 percent for corporations with taxable income in excess of $10 million. Limits are also placed on several business deductions, including the deductibility of club dues, executive compensation, the deductible portion of meals and entertainment expenses, and the amount of compensation that can be considered for tax-qualified pensions and retirement savings plans. Very few farm corporations have taxable income of $10 million. In addition, the limits on business deductions should have little or no impact on most farm corporations.

Increased Capital Expensing

Under prior law, farmers and other businesses could immediately deduct up to $10,000 of investment in farm machinery, equipment and other eligible depreciable property each year. The ability to expense $10,000 was limited to businesses with less than $210,000 in investments in depreciable assets per year.

The Act increases the amount of capital that can be expensed to $17,500 per year for businesses that invest less than $210,000. The increased expensing applies to investments made after January 1, 1993. This increase will allow over half of all farm investment in depreciable property to be currently deducted. Most farmers could simply deduct their total yearly investment in depreciable capital without being burdened by the complexities of determining allowable depreciation.

The ability to expense up to $17,500 per year would reduce the cost of depreciable capital for many farmers and other small businesses and encourage greater capital investment. Assuming a combined Federal income tax and self-employment effective tax rate of 28 percent, the estimated present value of the tax savings for an individual who invests $25,000 is $427 (table 6).

Exports of Unprocessed Softwood Timber

Under prior law, the income from exports of unprocessed softwood timber was eligible for favorable tax treatment that could substantially reduce the tax burden on such income. This treatment included: (1) rules that consider the source of part or all of such income as outside the United States, (2) rules that exclude such income from subpart F income which is currently taxable to a shareholder in a controlled foreign corporation, (3) eligibility for the exemption from

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[7] The longrun impact of this change is uncertain given the efforts to reform the U.S. health care system.

Table 6--Present value estimates of the benefits of increasing the the expensing provision to $17,500

	Expensing under prior law				Expensing under new law				Tax savings under prior and new law	
Depreciation schedule 1/2-year convention, 150% declining balance	Expensing	Depreciation	Depreciation + expensing	Present value 8%	Expensing	Depreciation	Depreciation + expensing	Present value 8%	Tax savings, prior law, present value basis	Tax savings, new law, present value basis
10.71%	$10,000	$1,607.0	$11,607.0	$11,607.0	$17,500	$803	$18,303	$18,303	$3,249.9	$5,124.8
19.13%	$0	$2,869.5	$2,869.5	$2,656.9	$0	$1,435	$1,435	$1,329	$743.9	$372.1
15.03%	$0	$2,254.5	$2,254.5	$1,932.9	$0	$1,127	$1,127	$966	$541.2	$270.4
12.25%	$0	$1,837.5	$1,837.5	$1,458.7	$0	$919	$919	$730	$408.4	$204.4
12.25%	$0	$1,837.5	$1,837.5	$1,350.6	$0	$919	$919	$675	$378.1	$189.0
12.25%	$0	$1,837.5	$1,837.5	$1,250.6	$0	$919	$919	$625	$350.1	$175.0
12.25%	$0	$1,837.5	$1,837.5	$1,158.0	$0	$919	$919	$579	$324.2	$162.1
6.13%	$0	$918.8	$918.8	$536.0	$0	$460	$460	$268	$150.0	$75.0
100.00%	$10,000	$15,000.0	$25,000.0	$21,950.0	$17,500	$7,500	$25,000	$23,475	$6,145.8	$6,573.0

Under prior law, a farmer could expense up to $10,000 of an investment in farm machinery and equipment and depreciate the remaining balance over 7 years at a 150% declining balance rate. The new law increases the amount that can be expensed to $17,500. For a $25,000 capital investment and assuming a 28 percent combined effective Federal income and self-employment tax rate, the new law generates an additional $1,875 in tax savings the first year. Assuming an 8 percent discount rate, the new law generates a present value tax savings of $427 compared with prior law.

Federal income taxes for export property of a foreign sales corporation (FSC), and (4) eligibility for the income tax deferral available to qualified export property of a Domestic International Sales Corporation (DISC).

The Act modifies the tax treatment applicable to exporters of unprocessed softwood timber. The definition of "export property" for purposes of the FSC and DISC rules excludes any unprocessed softwood timber. The sales source rules as they apply to inventory property are modified such that any income from the sale of unprocessed softwood timber cut within the United States is considered domestic source income. The Act also treats any income derived by a controlled foreign corporation in connection with the sale of any unprocessed softwood timber cut within the United States as subpart F income currently taxable to U.S. shareholders. In addition, the Act treats as subpart F, any income derived by a controlled foreign corporation from milling such timber outside the United States. These changes will increase the tax burden on exported unprocessed timber and should reduce incentives to export such timber.

Tax Changes Affecting Rural Areas

Empowerment Zones and Enterprise Communities

In recent years, many States have established enterprise zones. Experience with State enterprise zone programs has demonstrated that these zones can be a modestly effective and reasonable-cost method of creating jobs in economically disadvantaged areas. The limited information available further suggests that rural zones are as cost effective in producing jobs as urban zones. However, rural areas are frequently at a disadvantage in competing for such zones. See Reeder (1993) for an analysis of the development potential for enterprise zones in rural areas.

The Act establishes a number of Federal empowerment zones and enterprise communities and allocates part of the zones and communities to rural areas. Designated empowerment zones will receive grant funds and will be eligible for tax-exempt facility bonds and other tax incentives including an employer wage credit and increased capital expensing. Enterprise communities are only eligible for the tax-exempt facility bonds. Zone designations will last 10 years.

Under the Act, nine empowerment zones and 95 enterprise communities will be designated in 1994 and 1995. Three empowerment zones and 30 enterprise communities will be located in rural areas guaranteeing that rural, as well as urban, areas will benefit from the program. Empowerment zones and enterprise communities will be designated from areas nominated by State and local governments. The Secretary of Agriculture will designate eligible rural areas, defined as areas outside a metropolitan statistical area, plus other regions determined to be rural by the Secretary of Agriculture.

To be eligible for designation as a rural empowerment zone or enterprise community, the area must have a population of 30,000 or less, cannot exceed 1,000 square miles, and must be located within no more than three contiguous States. The area must suffer conditions of pervasive poverty, unemployment, and general economic distress. Each census tract must have poverty rates of at least 20 percent. Ninety percent of the tracts must have poverty rates of at least 25 percent, and half must exceed 35 percent. Finally, a strategic plan detailing proposed activities, methods, available resources, and requested Federal program support must be submitted by the State and local governments in which the area is located. The plan must indicate how to measure success and cannot incorporate actions that assist firms to transfer their operations into the zone.

Designations of rural empowerment zones and enterprise communities will be made on the basis of the strategic plan, on the assurances that such a plan will be implemented, and on other criteria to be determined by the Secretary of Agriculture.

The employer wage credit available to businesses in designated empowerment zones is a 20-percent credit against income tax liability for the first $15,000 of qualified wages paid to each employee who is a zone resident and who performs substantially all employment services within the zone. The maximum credit per qualified employee is $3,000 per year. The 20-percent rate only applies to the first 7 years. The last 3 years it diminishes to 15, 10, and 5 percent. The wage credit is available for a qualified employee regardless of the number of other employees who work for the employer or whether or not the employer satisfies the definition of an enterprise zone business. However, certain individuals cannot be qualified employees. These include an individual employed for less than 90 days, certain individuals related to the employer, and an employee in those businesses specifically excluded from the definition of an enterprise zone business.

An enterprise zone business is a proprietorship, partnership or corporation whose (1) sole trade or business is the active conduct of a qualified business within an empowerment zone or enterprise community; (2) at least 80 percent of the total gross income is derived from the active conduct of a qualified business within the zone;[8] (3) substantially all use of its tangible property occurs within a zone; (4) substantially all intangible property is used in and is exclusively related to the active conduct of such business; (5) substantially all services performed by the employees are performed within the zone; (6) at least 35 percent of the employees are residents of the zone and (7) no more than 5 percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to certain financial property or collectibles.

However, certain types of businesses are specifically excluded from the definition of an enterprise zone business. These include a private or commercial golf course, country club, massage parlor, hot tub or suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages. Any farm business with farm assets in excess of $500,000 is also specifically excluded.

For an enterprise zone business within a designated empowerment zone, the capital expensing allowance of $17,500 currently available to all businesses with less than $210,000 in capital investments, will increase by an additional amount equal to the lesser of $20,000 or the cost of qualified zone property placed in service during the tax year. The previous rules governing the types of property eligible for expensing and the phase out for businesses with investment above $210,000 continue to apply.

The Act creates a new category of exempt facility, private activity bonds referred to as qualified enterprise zone facility bonds. Ninety-five percent of the net proceeds of these bonds must be used to finance qualified zone property, the principal user of which is a qualified enterprise zone business. These bonds are fully subject to the State private activity bond volume caps and the restrictions on bank deductibility of interest allocable to tax-exempt bonds.

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[8] A qualified business is any trade or business other than the development or holding of intangibles for sale or license, or the leasing of real or personal property (unless 50 percent of the gross rental income form real property and substantially all of rental income to personal property is from zone businesses). Certain other trades or businesses described in the Internal Revenue Code Section 144(C)(6)(B) are also specifically excluded.

Extending the Authority for Small-Issue Bonds

Prior to June 30, 1992, interest on small-issue bonds used to provide low-interest loans to first-time farmers was exempt from Federal income taxes. This exemption allowed State and local governments to provide up to $250,000 in low-interest loans to a first-time farmer. Many States with agricultural loan programs use tax-exempt bonds as their source of funding. The Act permanently extends the exemption, providing a stable source of funding that will allow State and local governments to continue their efforts to encourage farm ownership by young farmers.

Tax Credit for Contributions to Community Development Corporations (CDC's)

Under prior law there were no specific tax credits available for contributions to community development corporations. Under the Act, an individual can claim a tax credit for a qualifying contribution to a designated community development corporation. The tax credit equals 5 percent per year for a 10-year-period following the contribution. The Secretary of Housing and Urban Development may select up to 20 CDC's to participate in the program, at least 8 of which must operate in rural areas. Each CDC can designate up to $2 million in new contributions to be eligible for the credit. The tax credit for contributions to designated CDC's should increase the funds available to such organizations to promote employment and business opportunities in rural areas.

Rollover of Gains into Small Business Investment Companies

Under prior law, gains on the sale, exchange or other disposition of publicly traded securities were normally recognized in the year of the sale. The Act allows an individual or corporation to elect to roll over the gain upon the sale of publicly traded securities if the proceeds are used to purchase common stock or a partnership interest in a small business investment company (SBIC) within 60 days of the sale. SBIC's supply equity capital, long-term financing, and management assistance to qualifying small businesses. A qualifying SBIC is any partnership or corporation licensed by the Small Business Administration under section 301(d) of the Small Business Investment Act of 1958. Section 301(d) SBIC's (also referred to as Specialized SBIC's) provide assistance to small businesses owned by socially or economically disadvantaged persons. The amount of gain that can be excluded for individuals is limited to $50,000 per year up to a total of $500,000 ($250,000 per year and $1,000,000 total for corporations). Based on recent data from the Small Business Administration, the 133 301(d) SBIC's in 1990 had total private capital of over $200 million.[9] Allowing individuals and corporations to roll over gains on public securities in 301(d) SBIC's has the potential to greatly increase the level of private capital available to provide assistance to socially or economically disadvantaged businesses.

Conclusions

The Revenue Reconciliation Act of 1993 contains numerous tax provisions that will affect farmers and rural residents. With the exception of the transportation fuels tax, most farmers and rural Americans will not be directly affected by the tax increases contained in RRA 1993. Furthermore, the effect of the increase in the Federal excise tax on transportation fuels should be relatively small. At the same time, the tax incentives contained in RRA 1993 will benefit most farmers and rural Americans. Including rural areas in the empowerment zones and enterprise communities should stimulate employment in the selected rural communities and will enable

[9] Directory of Small Business Investment Companies, p. III.

officials to evaluate the effectiveness of such programs on business formation and job creation in rural areas. The expansion and simplification of the EITC should boost the income of many farm sole proprietors and rural low-income working families and individuals. The extension of the self-employment health insurance deduction will reduce the out-of-pocket health insurance expenses of self-employed rural individuals and farmers. Farmers will also benefit from the increase in the capital expensing allowance, which should stimulate capital investment. Finally, beginning farmers should find credit more accessible, since the sunset provision on small-issue bonds ("aggie" bonds) has been removed. Overall, benefits from the tax incentives contained in RRA 1993 should outweigh the negative effects of the tax increases for most farmers and rural residents.

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